

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE

The meeting was called to order by REPRESENTATIVE DALE SPRAGUE at _____
Chairperson

3:30 XX a.m./p.m. on MARCH 23, 1988 in room 531-N of the Capitol.

All members were present except:

Representative Wells
Representative Brady
Representative Schauf

Committee staff present:

Emaline Correll, Research Department
Chris Courtwright, Research Department
Bill Edds, Revisor of Statutes Office
Nancy Wolff, Secretary

Conferees appearing before the committee:

Senator Dave Kerr
Don Collins, Collins Industries, Inc.
Larry McGill, Independent Insurance Agents of Kansas
Dick Brock, Kansas Insurance Department
Jerry Slaughter, Kansas Medical Society
Tom Bell, Kansas Hospital Association
Harold Rienur, Kansas Association of Osteopathic Medicine

The meeting was called to order by the Chairman.

Chris Courtwright, Research Department, reviewed Senate Bill 489, which would enact a new insurance law allowing for the creation of captive insurance companies. Two type of captive companies would be allowed: a pure captive company which would insure only the risks of its parent and affiliated companies and an industrial captive which would insure risks of the industrial insureds that comprise the industrial insured group and their affiliated companies.

Senator Dave Kerr, sponsor of the bill testified as a proponent of the legislation. Senator Kerr presented testimony in support of the legislation. (Exhibit I) He stated that the idea behing this legislation was to make it easier for Kansas companies, principally manufacturers, to form captive insurance companies to insure against product and completed works liability.

Don Collins, Collins Industries, Inc., of Hutchinson, testified as a proponent of the legislation. He related some problems his company has had with obtaining insurance, at a reasonable cost, due to a number of unfortunate incidents with his company. He testified that his company had looked into the possibility of forming a captive company in Vermont, but found the laws in Vermont to be prohibitive.

Dick Brock, Kansas Insurance Department, testified that the department had some problems with Senate Bill 489 in its original form, as it related to Association captives, but that it would be able to work with the current form of the legislation.

Larry Magill, Jr., Independent Insurance Agents of Kansas, testified in opposition to Senate Bill 489. (Exhibit II)

Tom Bell, Kansas Hospital Association, testified in support of Senate Bill 489. He stated that the legislation would allow associations of health care providers to form mutual insurance companies to bring stabilization to the market.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE,
room 531-N, Statehouse, at 3:30 Xa.m./p.m. on MARCH 23, 1938.

Wayne Stratton, attorney for both the Hospital Association and the Kansas Medical Society, presented a balloon (Exhibit III) showing amendments proposed which were primarily clean-up in nature. Representative Sprague asked Mr. Stratton why "Association" is not defined in the bill and Mr. Stratton responded that it was merely an oversight and a definition would be provided to the committee.

Jerry Slaughter, Kansas Medical Society, testified that the cost of medical malpractice is rising and by joining with the Hospital Association, they would be able to form a mutual insurance company for the benefit of their members.

Dick Brock, Kansas Insurance Department, testified that SB 677 would permit health care provider associations which have been in existence for ten years or longer to form an assessable mutual insurance company. He related four basic differences between this type of insurer and other mutual insurers (Exhibit IV)

There being no opponent to the legislation, the meeting was adjourned.

VISITORS TO HOUSE INSURANCE COMMITTEE

DATE: 3-23-88

NAME

REPRESENTING

Dick Buck	Ins Dept
TERRY TIEDE	Ins. Dept.
Kee WRIGHT	Farmers Ins. Group
Ray St...	KWS KHA
Tom Bell	KHA
JERRY SLAUGHTER	KWS
AROLD REXON	K40M

SB 489 CAPTIVE INSURANCE COMPANIES

Purpose: To make it easier for Kansas companies, principally manufacturers, to form captive insurance companies to insure against product and completed works liability.

Problems with Existing Laws:

Because our existing laws were designed for insurance companies which sell insurance to outsiders, they include measures which are not appropriate for a captive insurance company. Examples include:

- Minimum capital - \$900,000
- Minimum surplus - \$600,000
- Maximum for one policyholder - 10% of cap & surplus
- Many regulations and examinations

Benefits of enacting a captive law:

- * More large and medium sized Kansas companies will pay premiums to Kansas captives rather than out of state insurance companies
- * Kansas captives will keep more capital and surpluses in Kansas financial institutions.
- * Profitability of Kansas manufacturers will be improved and thereby employment will be enhanced.
- * Some additional premium taxes might be collected.

'Captives' Worth \$1 Million In Tax Revenue to Vermont

By SUSAN YOUNGWOOD

Free Press Staff Writer

Many United States companies have found a way to lower their insurance costs — and Vermont is benefiting from their discovery.

Companies are creating their own insurance companies — known in the industry as captives — in response to rising liability insurance bills. Many of them are locating these new companies in Vermont, because of a 1981 state law.

There are now 52 captive insurance companies in the state, which makes Vermont the largest domicile of captives in the United States.

"Everyone and his brother wants to set up a captive here," said Edward E. Meehan, chief examiner for the state Department of Banking and Insurance.

With a captive, companies are insuring themselves instead of going to a traditional insurance firm. They can control their losses and their premiums, while not paying for a traditional insurance company's overhead.

Captives started coming to Vermont

when the state changed the statutes in 1981. The new law treats captives separately from traditional insurance companies, requiring less capitalization, for example, and not asking for preapproval of forms and rates, like other states do.

Before Vermont changed its law, companies set up captives offshore, mainly in Bermuda and the Cayman Islands. Since 1981, such companies as Boeing, Mobil Corp., Citicorp and Toyota Motors have created captives in Vermont.

The impact of the captives has been substantial.

Last year captives paid \$800,000 in state premium taxes. This year, Meehan projects, the tax could exceed \$1 million — about the same amount state banks pay.

In the past five years, 10 risk management firms have opened offices in the state. Captives use these firms to manage their policies.

Some of these firms were started in Vermont; others are satellite offices of nationwide companies.

"We have jobs that weren't here be-

fore the law," said H. Lincoln Miller Jr., president and founder of Vermont Insurance Management, one of the state's larger management firms.

Vermont Insurance manages a dozen captives, and recently bought a building in Berlin for its five employees.

"We've really grown," he said. "We've gotten five new captives in the last three months."

Vermont attorneys and banks also benefit from the captives, from the additional workload and increased bank deposits.

The three captives that use Vermont National Bank have more than \$1 million in deposit accounts, said John Hashagen, senior vice president at the bank.

The captives use the bank to issue letters of credit, for which the bank charges a fee.

"It's good business for the bank," Hashagen said. "They have brought a lot of money into the state."

Vermont also sees increased business
Turn to CAPTIVES, 8C

Captives Lucrative for State

From Page 6C

travel, when the parent company executives visit the state.

Marlin Henning, the risk manager for LLC Corp., runs the firm's captive insurance company from Dallas. Henning comes to Vermont six or seven times each year, sometimes spending a whole week. The captive has a Vermont bank account with a \$1 million balance.

Henning explains why his company decided to come to Vermont in 1983.

"One of my selling points here was patriotic — we wanted to bring our money back into the states," Henning said. "It cost a lot less to operate in Vermont (than Bermuda) — the travel is a little bit less, room and board is significantly less, the corporate secretary costs are a lot less."

Other states have captive insurance laws, but Henning chose Vermont.

"Oh, I did look at all the other states. There was just no comparison. Vermont is the best," Henning said.

Being in Vermont, he added, "saves us a lot of money in premi-

ums."

Just because Vermont's law is flexible does not mean the captives are not regulated, risk managers say.

Meehan studies each applicant carefully, turning down captives which are not well-capitalized. Because captives are backed by financially solid, often multimillion-dollar conglomerates, the chances of the captives' going insolvent are slim, Meehan explained, because the whole firm would have to go bankrupt for the captive to collapse.

Plus, he added, "No one in Vermont could be hurt if a captive became insolvent."

The number of captives coming to Vermont started burgeoning when liability insurance became scarce and expensive.

"The insurance crisis is definitely pushing people into our laps," said Vincent Bell, who heads American Risk Management.

Tax law changes also brought more companies to Vermont, and the pending tax reform could bring even more, said Ray Oberg, vice president of M & M Insurance Services Inc., another management firm.

"Captives will really prove to be a boom for Vermont," he said.

Testimony Before The House Insurance Committee
on SB 489

March 23, 1988

By: Larry W. Magill, Jr., Executive Vice President
Independent Insurance Agents of Kansas

Thank you for the opportunity to appear in opposition to SB 489 as it was amended on the Senate Floor. The proposal allows the formation of both pure captives (single company captives) and industrial captives (multi-firm captives).

We have no concerns with an act allowing the formation of "pure" captive insurance companies. They are essentially the same as self-insurance by a single company or a number of related companies through a holding company or similar ownership control. As long as a bill that only addressed pure captives dealt with the inequities that could be created with our assigned risk plans and, if workers' compensation were included, the workers' compensation fund and administrative costs, we would have no objection. With these provisions, they could be granted all lines authority and very minimal Insurance Department regulatory control.

However, "industrial insured" captives are basically pools, just like the public entity pools allowed to be established under Substitute for SB 250 passed last year. Although we are certain it is not the intent of the sponsor of the bill nor the two large manufacturing firms who appeared in the Senate, we are concerned that any legislation allowing the formation of insurance companies adequately address the areas of financial soundness and solvency and consumer protection for both buyers of the coverage and injured third parties.

As long as the bill contains the industrial insured captive insurance company provisions, we oppose it without the following

amendments:

1) Change the definition of firms eligible to join an industrial insured captive from \$25,000 in annual premium volume to \$250,000 of annual property-casualty premium volume and change from 25 employees to 100 employees. (lines 55-57)

This will insure that only sophisticated buyers are sold on joining a captive. We do not believe that firms with annual aggregate insurance premiums of \$25,000 which could include group health premiums and includes many "main street" businesses would understand the risks they are assuming by joining a captive, both investing their money and purchasing coverage from one.

While the limitation, added on the Senate Floor, to no more than 15 companies forming an industrial insured captive is a step in the right direction, we feel our proposed amendment would provide further protection. The \$250,000 requirement will help insure that the captive will have sufficient premium volume to have an opportunity to survive. Keep in mind that the legislation does not require a minimum premium volume nor are these captives likely to have a very good spread of risk. Insurance is based on the law of large numbers, yet the proposal would allow captives to be formed with a small number of insureds, assuming they can meet the capital requirements in the bill.

2. Change the types of insurance coverage that can be provided by captives back to products and completed operations liability only as the bill was passed by the Senate FI&I Committee and as recommended by the Senate's Subcommittee on Insurance, which studied the proposal on approximately four separate occasions. (lines 101-106)

This is admittedly a very restrictive provision, but is consistent

with the testimony given during the Senate hearings. Both the manufacturing firms that appeared testified that they had problems obtaining adequate limits of products liability coverage at affordable prices. The more lines of coverage that a captive writes, the more risk it runs of financial disaster. It will be difficult enough for captives to adequately underwrite the products/completed operations risks it assumes for its members without adding all the other general liability exposures, commercial auto, property and inland marine coverages that could be written as the bill is presently drafted.

The Senate Subcommittee on Insurance also felt that with the limited amount of time during this session to consider the legislation, it is better to begin slowly with captive legislation and grant products/completed operations authority only. With additional time and experience, it is conceivable that the lines of coverage authorized could be expanded.

3. In all fairness, with the amendments suggested in #1 and #2 above, we would support eliminating the 15 firm limitation on the number of companies that can join industrial insured captives. We are not concerned with the size these captives reach so long as they are sold or marketed to firms large enough to appreciate the risks they are taking with their capital investment and their insurance coverage in a captive.

In addition, we would like to point out the following items for the committee's consideration :

1. We do not believe Kansas needs to compete with other states for the weakest state laws on captives. At the moment, only a handful of states have passed very loose captive laws to encourage their

formation within their state.

2. We ask the committee to keep in mind that unlike SB 677 allowing the formation of health care provider mutuals, this legislation begins by exempting these insurance companies from all of the insurance laws and regulations. (lines 406-409)

3. We feel the committee should grant the Insurance Department some control over captive insurance companies' rates and forms. For example, the Star Pool, which is very similar to the captive operation, has used a policy form in Kansas that not only does not provide any "tail" coverage for insureds who withdraw from the pool, but also requires those insureds to take their open claims with them. This is a policy form the Insurance Department would never have approved had it had the authority to review the form.

4. The committee should consider requiring licensing of agents, if used by captives, for the sale or solicitation of participation in the captive. Although it is unlikely that these captives will ever be marketed through agents, it is conceivable. This requirement is not of major importance because current Kansas law allows "traveling, salaried representatives" of insurance companies to operate without licensing. This loophole could be used by captives as well.

5. The committee should require that reserves be actuarially sound and reinstate the language contained on lines 273-275 allowing the Commissioner to determine the form of the annual financial reports. As we know from our experience with the Health Care Stabilization Fund, one of the quickest ways for an insurance company to wind up in financial difficulty is to under reserve pending claims or fail to recognize incurred but not reported losses.

Max Meyer

The impetus for this legislation is clearly from a few large manufacturers who now have the option of forming captives in any other state with a captive law. They do not have to have a captive law in Kansas to use this alternative financing vehicle.

In addition, under the Federal Risk Retention Act, whatever the legislature does here in Kansas could have a national impact. Risk retention groups under the federal law could use the Kansas captive law to write insurance countrywide. We question whether the legislature wants to assume that responsibility and burden our Insurance Department with the additional costs of administering and reviewing captive applications.

Perhaps one reason the Insurance Department has never proposed a captive bill of its own is that they could see no reason to set up preferential treatment for one type of insurance company over another. If soundness and solvency coupled with protection for buyers and claimants is important for some insurance companies - why not all?

We urge the committee not to act favorably on SB 489 without our amendments.

* or one or more clean and irrevocable letters of credit,
** or letters of credit
*** clean and

**** , for the benefit of the state treasurer and commissioner, in an amount not less than the minimum capital stock required of a domestic stock insurance company. For the purpose of this act, letters of credit shall be in the form allowed by K.S.A. 40-221a(b)(2) drawn on the account of a health care provider for the benefit of the company, or for the benefit of the state treasurer and commissioner if the letter of credit is on deposit in accordance with this section.

*Any
**may

***so long as the company's surplus as reported upon such basis remains above \$1 million, unless the Commissioner determines the method used by the company to arrive at the present value of it's liabilities for losses and loss adjustment expense is based upon unreasonable assumptions.

0120 which application has been made. The total of such considera-
0121 tion shall be held in cash or securities in which such insurance
0122 companies are authorized to invest, and it shall possess and
0123 thereafter maintain a surplus of lawful assets over and above
0124 liabilities in an amount not less than the capital and surplus
0125 required of a domestic stock insurance company transacting the
0126 same kinds of insurance. The company shall deposit with the
0127 state treasurer and commissioner, as joint custodians, securities
0128 in which such insurance companies are authorized to invest, or
0129 one or more irrevocable letters of credit ~~issued by a bank char-~~
0130 ~~tered by this state or by a member bank of the federal reserve~~
0131 ~~system, for the benefit of the state treasurer and commissioner, as~~
0132 ~~joint custodians, in an amount not less than the minimum capital~~
0133 ~~stock required of a domestic stock insurance company.~~

0134 New Sec. 8. No insured shall be liable for any amounts other
0135 than the annual premium and all assessments as provided in the
0136 articles of incorporation or bylaws. The business of the company
0137 shall be conducted so as to preclude any distribution of income,
0138 profit or property of the company to the individual members
0139 thereof except in payment of dividends, debts, claims or indem-
0140 nities or upon the final dissolution of the company.

0141 New Sec. 9. Each company organized pursuant to this act
0142 shall file an annual statement each year in accordance with the
0143 requirements for domestic insurers writing the same kind of
0144 insurance. ~~The commissioner shall permit any company orga-~~
0145 ~~nized pursuant to this act to state its liabilities for losses and loss~~
0146 ~~adjustment expenses on a present value basis in any statement or~~
0147 ~~report which the company is required to file unless the commis-~~
0148 ~~sioner determines that such a method of valuation endangers the~~
0149 ~~financial condition of the company, given the condition of such~~
0150 ~~company, and requires that it be stated otherwise.~~

0151 Sec. 10. K.S.A. 13-14b11 is hereby amended to read as fol-
0152 lows: 13-14b11. The board of trustees shall have exclusive con-
0153 trol of the management and operation of the hospital and shall
0154 make and adopt such rules and regulations for the government of
0155 the hospital as may be deemed expedient for the economical and
0156 proper conduct thereof: ~~Provided,~~ The board of hospital trustees

EXHIBIT III

Comments on Senate Bill No. 677
Presented by Dick Brock, Kansas Insurance Department
March 23, 1988

Senate Bill No. 677 will permit health care provider associations which have been in existence for ten years or longer to form an assessable mutual insurance company. Such company would be authorized to provide liability insurance to the members of the sponsoring association or associations.

The company formed under Senate Bill No. 677 would be required to comply with all laws relating to mutual insurance companies generally except as such laws are modified by the provisions of Senate Bill No. 677. As a result, the significant differences between the requirements applicable to Senate Bill No. 677 companies and other mutual insurers are four in number. These differences are as follows:

(1) Senate Bill No. 677 would allow a company formed under this section to expose itself to loss on any one risk or hazard in an amount not to exceed 20% of its surplus, unless the excess is reinsured.

Companies formed under all other sections are subject to a 10% requirement.

(2) Senate Bill No. 677 would allow a company formed under this section to report its liabilities for loss and loss adjustment expenses on a present value basis (discounting).

No other companies are allowed to report their liabilities in this manner.

(3) Senate Bill No. 677 would allow a company formed under this section to utilize letters of credit to meet the surplus and deposit requirements of this state.

Letters of credit are not allowable for other companies.

(4) Senate Bill No. 677 allows companies to form on the assessable plan.

No other companies may issue assessable policies in Kansas.

Because of the severely limited liability insurance markets for health care providers and because a company formed by health care providers to provide coverage for health care providers should bring some stability to the medical malpractice insurance environment, the Insurance Department supports Senate Bill No. 677.